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(I)



In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 376

FREDERIC W. PROCTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 12a-20a), entered July 6, 1943, are unreported. The opinion of the United States Circuit Court of Appeals for the Fourth Circuit, filed April 11, 1944 (R. 71-77), and its *per curiam* opinion upon rehearing (R. 91-93), are reported in 142 F. (2d) 824, 828.

JURISDICTION

The judgment of the circuit court of appeals was entered on April 11, 1944 (R. 78). The petition for rehearing was denied May 31, 1944 (R.

93). The petition for a writ of certiorari was filed August 21, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a gift by petitioner of his remainder interests in two trusts created by his grandfather is so vague, conditional, contingent, and speculative as to be impossible of valuation by any actuarial or other recognized method, either because the corpus might be subjected to the payment of a debt owed by petitioner, or because his right thereto depended upon his outliving the life beneficiary.

2. If the gift be taxable, whether any tax is due since the trust indenture provides that, if a federal court of last resort determines that any of the gift is taxable, the property shall be deemed not included in the conveyance.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 501. IMPOSITION OF TAX.

(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether

the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; * * *. The tax shall not apply to a transfer made on or before the date of the enactment of this Act.

* * * * *

Treasury Regulations 79 (1936 Ed.):

ART. 2. *Transfers reached.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real, or personal, tangible or intangible. Thus, for example, a taxable transfer may be effected by the declaration of a trust,
* * *.

ART. 3. *Cessation of donor's dominion and control.*—The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable. * * *

ART. 11. *Future interests in property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal

term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. * * *

STATEMENT

On January 13, 1939 the petitioner, Frederic W. Procter, made a gift in trust to his surviving children or the issue and widows of any children predeceasing him of so much of his future right, title, and interest in each of two trusts which had been established by his grandfather as would remain after the payment of a debt to his mother of \$686,300.03 (R. 12a-16a). The petitioner reserved a life interest in the trust he had created (R. 27). On the date of the transfer in question, the petitioner was 36 years of age and his mother 63 (R. 5a). One of the trusts created by the petitioner's grandfather was an *inter vivos* trust; the other was testamentary (R. 5a-6a). Under the terms of the *inter vivos* trust, valued at \$928,593.70 at the date of the gift, the petitioner was to receive the corpus thereof upon the death of his mother, the life tenant, if he survived her. Under the terms of the testamentary trust, valued at \$961,552.68 at the date of the gift, he was to receive the corpus thereof upon the death of his mother if he reached the age of 40 and survived her. (R. 13a.)

The eleventh article of the trust indenture (R. 14a, 34) provides as follows:

The settlor is advised by counsel and satisfied that the present transfer is not subject to Federal gift tax. However, in the event it should be determined by final judgment or order of a competent Federal Court of last resort that any part of the transfer in trust hereunder is subject to gift tax, it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of Frederic W. Proctor free from the trust hereby created.

In calculating the net value of the petitioner's interests in these trusts, the Commissioner, in effect, deducted the petitioner's indebtedness to his mother from the value of the corpora of the trusts, by deducting it in full from the value of the corpus of the *inter vivos* trust because that was greater than the debt. He then applied a separate actuarial factor to the value of the petitioner's interest in each trust, as ascertained, in order to determine the present value of the gift of the corpus of each. (R. 8a-11a.) These factors were later incorporated in a stipulation filed with the Tax Court (R. 6a) and were adopted by it in its findings (R. 16a). The factor thus applied by the Commissioner to the value of the

petitioner's interest in the *inter vivos* trust was \$0.25152, representing the present worth of the right to receive \$1 at the death of a person aged 36, provided that a person aged 63 shall have died before him (R. 10a). And the factor thus applied by the Commissioner to the value of the petitioner's interest in the testamentary trust was \$0.24883, representing the present worth of the right to receive \$1 at the death of a person aged 36, provided such death occurs after four years and after the death of a person aged 63 (R. 11a).

Accordingly, the Commissioner determined that the value of the gift of both interests was \$310,252.32 (R. 11a) and that the tax thereon was \$36,487.85 (R. 9a). At the hearing before the Tax Court, however, the Commissioner conceded that under the stipulated total value on the basic date of the corpora of the trusts, using the factors employed in his notice of deficiency (Commissioner's Exhibit F, R. 8a-11a), the value of the gift would be \$300,204.86 (R. 17a).

The Tax Court held that, since the debt was payable on demand, as the petitioner had contended, and not alone at the death of his mother, as the Commissioner had contended (R. 18a-20a), the debt was not deductible from the value, on the date of the gift, of the corpora of the trusts, but from the value on that date of the petitioner's interest therein. But, in determining the value of the gift made of the petitioner's interest in the

inter vivos trust, the Tax Court applied the first stipulated factor to the stipulated value of the corpus of that trust, instead of to the value of the petitioner's interest therein, which it did not ascertain. Similarly, the Tax Court determined the value of the gift made of the petitioner's interest in the testamentary trust by applying the second stipulated factor to the stipulated value of the corpus of that trust, instead of to the value of the petitioner's interest therein. Thus the Tax Court determined that the total value of the petitioner's interests in the corpora of the trusts, as of the date of the gift, was less than his indebtedness to his mother, and that the gift of the residue of his interests therefore had no value. Accordingly, it held that the petitioner was not liable for any tax. (R. 19a-20a.)

The court below sustained the Tax Court in holding that the petitioner's debt to his mother should be deducted from the value of his interests in the trusts rather than from the value of their corpora (R. 73-74). However, as the court below pointed out, the Tax Court had, by applying the stipulated factors to the value of the corpora of the trusts, instead of to the value of the petitioner's interests therein, in effect, ascertained the present value of the petitioner's interests in the trusts not with reference to his mother's death, when he became entitled thereto, but with reference to his own death, when his children would receive the economic benefits of his gift. The court below

held that, in this respect, the Tax Court had committed reversible error. (R. 74.) It therefore remanded the case to the Tax Court for further proceedings not inconsistent with its opinion (R. 77); that is, to determine the amount of the tax by the use of a formula which the court below explained, and which involved the use of what the court regarded as the proper criteria in its determination (R. 74-75). The court below also rejected the petitioner's contention that the decision of the Tax Court should nevertheless be affirmed on three additional grounds, namely, (1) that the interests subjected to the gift tax would be subject to estate tax upon the petitioner's death and hence were not subject to gift tax; (2) that the interests of the petitioner in the trusts were of too contingent a character for a gift thereof by him to be subject to the gift tax, and (3) that under the eleventh article of the trust indenture the gift was not to become effective if subject to a gift tax (R. 75-77).

The petitioner filed a petition for a rehearing (R. 79-90), which the court below denied pursuant to a *per curiam* opinion in which it not only rejected the petitioner's complaint that the computation made in its opinion by way of illustration for guidance of the Tax Court was improper, but also again disposed of the three above-mentioned contentions which the petitioner had renewed (R. 91-93).

ARGUMENT

The petitioner does not challenge the decision of the court below either in respect of its holding that the Tax Court erred in the method it used in computing the value of the gift, or in respect of the method which the court required the Tax Court to use. The petitioner's complaint here is two-fold (Pet. 7): First, that the interests of the petitioner in the trusts created by his grandfather are "so vague, conditional, contingent and speculative as to be without any possible valuation by any actuarial or other 'recognized method'" and that, in requiring the valuation of such interests and the imposition of the tax upon the gift thereof, the decision of the court below is in conflict with the decision of this Court in *Robinette v. Helvering*, 318 U. S. 184. Second, that no tax was due because under the eleventh article of the trust indenture (R. 75), the gift was conditioned upon a final determination by a federal court of last resort that the gift was not subject to the federal tax.

1. The asserted conflict between the decision of the court below in the case at bar and the decision of this Court in the *Robinette* case is nonexistent. The principal question in that case was whether there was a taxable gift of certain remainders. The taxpayer's contention that the transfer of such remainders was not subject to the tax did not rest on the premise that her interest in the

property was contingent, for it was not, but on the premise that there were no donees at the date of the transfer who could accept the remainders. The Court rejected this contention and the petitioner does not claim that the decision of the court below is in conflict on this point with that of this Court in the *Robinette* case. It further appeared in that case, however, that the donor had retained a reversionary interest. She therefore made a further alternate contention that, in computing the value of the remainders, allowance should be made for the value of such interest, as was done in the case of *Smith v. Shaughnessy*, 318 U. S. 176. The Court also rejected this contention, pointing out that, whereas in the *Smith* case the grantor's reversionary interest depended only upon his surviving his wife, in the *Robinette* case the donor's reversion depended not alone upon the possibility of survivorship, but upon the death of the donor without issue who would reach the age of 21. There is obviously no such contingency here and no such question. Here the petitioner's right to receive the corpora of the trusts his grandfather had created depended solely, as regards the *inter vivos* trust, upon his surviving his mother and, as regards the testamentary trust, upon his surviving his mother and reaching the age of 40.

It is, of course, well settled that gifts of contingent interests are subject to the tax. Section

501 of the Revenue Act of 1932, *supra*, levies the tax upon all gifts, and Section 504 (b), set out in the margin,¹ excepts from the \$5,000 exclusion therein provided gifts of future interests. Thus the Court in the *Robinette* case, *supra*, said (p. 187) that gifts of future interests are taxable under Section 504 (b). The applicable regulation (Article 11 of Treasury Regulations 79 (1936 Ed.), *supra*) defines "future interests" as including reversions, remainders, and other interests or estates, whether vested or contingent; and this regulation has received the blanket approval of this Court. See *Estate of Sanford v. Commissioner*, 308 U. S. 39, and *United States v. Pelzer*, 312 U. S. 399. Moreover, the value of the gift of the petitioner's future interests here in question was not incapable of valuation either (a) because such interests were subject to a lien for the debt he owed his mother or (b) because of the contingency that he might not outlive her.

Both the Tax Court and the court below held that the debt was deductible from the value of the petitioner's interests in the trusts at the date of the gift. In order to determine such value, it was necessary only to take into account the conditions

¹(b) *Gifts Less Than \$5,000.*—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first \$5,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

under which the petitioner would receive those interests, namely, in respect to the *inter vivos* trust, that he survive his mother, and in respect to the testamentary trust that he survive her and reach the age of 40. The discount factors to be used in determining the value of the petitioner's interests in the trusts, in view of these conditions, were not stipulated as we have said.² These factors were, however, later computed and furnished to the court below by the Government on the appeal and their correctness was not questioned by the petitioner. To the contrary, in his petition for rehearing the petitioner said that he specifically agreed in open court to be bound by the Commissioner's two actuarial factors, of \$0.56445, as representing the present worth of the right of the petitioner to receive \$1 at the death of his mother, and of \$0.55377, as representing the present worth of \$1 payable at the death of his mother, provided he attained the age of 40 at that time, "exactly as the Government counsel have contended here." (R. 80.) It was by the use of these factors that the court determined the value on the date of the gift of the petitioner's interest

² While the reason why they were not stipulated is unimportant here, it is that their application became necessary only in view of the Tax Court's holding, which was not anticipated by the parties at the time the stipulation was entered into, that the debt was deductible from the value of the petitioner's interests in his father's trusts and not from the value of their corpora.

in the trusts and that, after deducting his debt to his mother therefrom, it determined that there remained a balance of \$668,731.98 as representing the value of the property from which the petitioner would receive income during his life and which would go to his children at his death. It is to this sum that the court below said the second stipulated factor should be applied to determine its present worth, which would be the amount subject to the gift tax (R. 74-75).³ Thus the taxpayer had interests in the trusts his grandfather had created which were subject to valuation in terms of money. That was all that was necessary to the imposition of the tax.

2. Since the condition imposed by the eleventh article of the trust indenture was one which, by its very nature, might never occur, the gift was complete, and the Commissioner was bound to determine the tax upon facts and circumstances existing on the date the gift was made. To allow the taxpayer then to carry the case through the federal courts, and finally, confronted with an adjudication upholding the Commissioner, to recall the property previously given because the gift was held taxable, would be to require the federal courts to render advisory opinions. Accordingly, the court below held the condition contrary to public

³ See also the Court's further explanation of this computation in its *per curiam* opinion denying the petition for rehearing (R. 92).

policy and, as such, invalid (R. 75-77). In any case, there is no conflict of decisions asserted on this point, and none in fact exists. So far as we are aware, a condition like that imposed by this trust indenture has not been encountered before.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1944.

